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SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1929.

No. 226

THOMAS A. EARLY, RECEIVER OF THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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(34,357)

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SUPREME COURT OF THE UNITED STATES.

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No. 226

THOMAS A. EARLY, RECEIVER FOR THE FARMERS & MERCHANTS NATIONAL BANK OF LAKE CITY, PETITIONER,

v.

FEDERAL RESERVE BANK OF RICHMOND, RESPONDENT.

PETITION FOR WRIT OF CERTIORARI.

MAY IT PLEASE THE COURT:

The petition of Thomas A. Early, as Receiver of the Farmers & Merchants National Bank of Lake City, South Carolina, respectfully shows to this Honorable Court:

A.

Statement of the Matter Involved.

In an action brought at law in the District Court of the United States for the Eastern District of South

In

Carolina, an order of judgment was made, on May 9th, 1928, by District Judge Ernest F. Cochran, in favor of petitioner, as plaintiff, against Federal Reserve Bank of Richmond, Virginia, as defendant, for the recovery of $22,088.48, with interest $1,417.38, aggregating in amount $23,505.86,—this being the amount of a deposit balance claimed by petitioner to be owing by the Reserve Bank to the Farmers & Merchants National Bank of Lake City, South Carolina, at the time of the failure of the latter bank (R. 11).

The Reserve Bank appealed. The finding of the District Court relating to the deposit account was reversed; the judgment set aside; and a new trial awarded; the decision of the Circuit Court being, however, final in effect, and conclusive upon the court below, in respect to the judgment to be entered in the cause. The decision of the Circuit Court sustained the right of the Reserve Bank to apply the deposit balance to the benefit and protection of depositing banks which had used its clearing house system to collect checks drawn on the failed bank (R. 68).

The issue raised by the answer of the Reserve Bank, and decided in its favor by the Circuit Court of Appeals, is stated in the brief of the Reserve Bank on argument before the Circuit Court, as follows:

> *Was the Federal Reserve Bank of Richmond entitled to charge the amount of the checks sent to the Farmers and Merchants National Bank of Lake City and accepted and cancelled by it before its failure against the apparent balance due to the Farmers and Merchants National Bank of Lake City at the time of the failure?*

The position taken by petitioner, as Receiver of the Lake City Bank, acting under instructions of the Comptroller of the Currency, is set out in his reply (R. 10).

1. The checks were received by the Reserve Bank for deferred credit and had not become available for withdrawal or other use by the sending banks at the time of the suspension and closing of the Lake City Bank.

2. In receiving and handling such checks for collection, the Reserve Bank did not become the owner of the paper, but acted only as agent of the banks from which it received the checks.

3. The Reserve Bank was notified of the suspension and closing of the Lake City Bank before the charges were made against the reserve account.

4. After notice of the suspension and closing of the Lake City Bank, no right existed on the part of the Reserve Bank to charge the reserve account of the failed bank with any outstanding collection items.

The case was tried under an agreement waiving jury, on a stipulation of facts (R. 15-23); the material facts being the following: On October 7th, 1926, the Reserve Bank forwarded for collection to the insolvent bank checks drawn against the latter amounting, less checks dishonored and returned, to $14,900.62. On October 8th the Reserve Bank forwarded checks amounting to $20,170.71. The insolvent bank received the first lot of checks on October 8th and the second on October 9th. It immediately acknowledged receipt

of them in each case; the accepted checks being marked paid and charged to the accounts of the various drawers. The bank closed its doors on October 9th, and passed into the hands of the Comptroller of the Currency. At that time its reserve balance with the Reserve Bank was $22,088.42. The Reserve Bank did not attempt to charge any of the checks to the account of the failed bank until after notice had been received of its failure. On October 11th, however, it did charge the first lot of checks against it, and on October 12th the second lot. The latter, however, were later credited to the account of the failed bank and charged against the customers of the Reserve Bank, from whom they had been received for collection, although the checks themselves were not, of course, returned. (Statement contained in opinion of Circuit Court (R. 70) substantially adopted.)

The Reserve Bank was handling the checks as collection agent under its clearing and collection system, which it had established under its authority to act as a clearing house for its member banks (Federal Reserve Act). For convenience of reference, the pertinent statutory provisions and the regulations of the Federal Reserve Board governing "check clearing and collection" are set out in full in Appendix A and Appendix B, following this petition. A check collection circular, or letter of instructions to member banks, was also issued by the Richmond Reserve Bank (R. 47). This was issued under the authorization of section VI of regulation J, series of 1924, as "governing the de-

tails of its check clearing and collection operations," which "shall be binding upon any member or non-member clearing bank which *sends* any checks to such Federal Reserve Bank for collection." The pertinent part of the circular, under the heading "Our Cash Letters to Member Banks," is the following:

> "Checks received by us drawn on our member banks will be forwarded in cash letters direct to such banks and each member bank will be required either to remit therefor in immediately available funds or to provide funds available to us to meet such cash letters within the agreed transit time to and from the member bank. Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter. The right is reserved, however, to charge a cash letter to the reserve account of a member bank at any time when in any particular case we deem it necessary to do so."

The two cash letters, under which the checks were forwarded to the Lake City Bank for collection, show the date of expiration of the agreed transit time on such collection items as follows: (1) "Dispatched October 7, 1926. Chargeable against *available balance* in reserve account, October 11, 1926"; (2) "Dispatched October 8, 1926. Chargeable against *available balance* in reserve account, October 12, 1926" (R. 62, 63). The drawee bank, charging the checks to the account of its own depositors, received no funds from

the collection. It had to provide the funds. It agreed to provide the funds by the date shown in the cash letters. The available funds in the reserve balance at that time would become chargeable if payment had not otherwise been made. The import of this agreement, and the actual practice thereunder, was that the reserve balance should be maintained as a general deposit account until the charge for outstanding checks was actually made against such account. The reserve balance was of constantly fluctuating and uncertain nature, subject to be checked against and withdrawn for the purpose of meeting existing liabilities. (See Appendix A.)

Attention in this connection is called to the ledger sheet, showing the condition of the insolvent bank's account from September 15, 1926, until the closing date of the bank (R. 64-65). The reserve balance of October 8, when the cash letter of October 7th was accepted by the Lake City Bank, was $32,196.00. Charges greatly exceeding this balance (amounting in the aggregate to over $55,000.00) were made on the 8th and 9th against the reserve account. Necessarily, therefore, the balance appearing in the reserve account of the 11th, after the bank had closed,—still lacking $12,982.85 of being enough to meet the two cash letters outstanding,—was created by deposits made subsequent to the drawee bank's acceptance of the checks contained in the cash letter of the 7th.

In the holding of the decision that the deposit balance is not recoverable by the receiver but should be

applied by the reserve bank upon the checks forwarded for collection, the Circuit Court places reliance upon the erroneous and unfounded premise that the use of the "cash letter" method of check collection was based on faith of the reserve balance; falling, in consequence of such erroneous premise, into the fundamental error that the contract of the parties had created an equitable charge upon the reserve account arising upon the acceptance of the checks by the failed bank.

B.

Reasons Relied on for the Allowance of the Writ.

1. An important question of banking law, arising under the Federal Reserve Act, and involving the construction of regulations issued by the Federal Reserve Board under the authority of said Act, is decided by the Circuit Court of Appeals in this case, in a way probably untenable, and probably in conflict with applicable decisions of this Court. The nation-wide field of banking interests that are covered by the Federal reserve clearing and collection system,—all rules and regulations of regional reserve banks being necessarily subsidiary to the regulations of the Federal Reserve Board,—make the present decision of even greater public interest and importance than the case of Equitable Trust Co. *v.* First National Bank of Trinidad, in which, the right to assert an equitable lien being upheld by the Circuit Court of Appeals (2d circuit), a writ of certiorari was granted (273 U. S. 684) and a decision rendered by this Court reversing the decision below (275 U. S. 359).

The position taken by the Circuit Court of Appeals is not consistant with the ruling made in the Bank of Trinidad case, *supra;* nor with the principles of general law governing equitable liens and charges, as determined by the weight of authority, and as recognized and applied by the Federal courts in the cases of Christmas *v.* Gaines, 14 Wall. 69; United States *v.* Butterworth-Judson Corp., 267 U. S. 387, and the Interborough Consolidated Corp. case, 288 F. 334, certiorari denied, 262 U. S. 752).

2. The decision, by sustaining and upholding the appropriation by the reserve bank of the reserve balance of a member bank, after it had closed, has probably allowed a preference to be made in favor of the holders of collection items handled through the Federal reserve clearing house system, contrary to statutory provision (12 U. S. C. A. 91), and conflicting with the Federal decision which, in Scott *v.* Armstrong, 146 U. S. 499, and various other cases cited in 12 U. S. C. A. 91, note 64, have held that no additional rights can be created by either voluntary or involuntary proceedings, after an act of insolvency has been committed.

3. The decision involves an important question of banking law, of Federal nature, which has not been, but should be, settled by this Court. There are twelve regional reserve banks in existence under the Federal Reserve Act (12 U. S. C. A. 222, and note); and having the authority to exercise clearing house functions for their member banks, and nonmember clearing banks, under the provisions of the Federal Reserve

Act, as amended by the Act approved June 21, 1917 (12 U. S. C. A. 248 (*m*)). Each of these regional banks has its own check clearing and collection system under the regulations issued by the Federal Reserve Board (Appendix B). An enormous volume of check collections is done through these channels. The question now in issue has for the first time been decided by one of the Circuit Courts.

In almost every national bank failure, and in a high percentage of State bank failures, similar questions are likely to arise. The amounts of dividends to be paid to many thousands of depositors concerned in such bank failures, as well as the equities of holders of the collection items, are dependent upon the determination of the question. In the public interest it is, therefore, of the highest importance that the question should be settled by this Court.

WHEREFORE your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the 4th Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 2,750, Federal Reserve Bank of Richmond, Appellant, *v.* Thos. A. Early, Receiver of the Farmers and Merchants National Bank of Lake City, Appellee, and that the said judgment of the said Circuit Court of Appeals may be reversed

by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

THOS. A. EARLY, RECEIVER
OF THE FARMERS & MERCHANTS NATIONAL BANK
OF LAKE CITY,

By R. E. WHITING,
Counsel for Petitioner.

APPENDIX A.

Provisions of Federal Reserve Act.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks (Section 16 of the Federal Reserve Act, 12 U. S. C. A. 248 (*m*)).

The required balance carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities; provided, however, that no bank shall at any time make new loans or shall pay any dividends unless and until the total balance required by law is fully restored (Section 19 of the Federal Reserve Act, 12 U. S. C. A. 464).

APPENDIX B.

Regulation J, Series of 1924.

(Superseding Regulation J of 1920.)

Check Clearing and Collection.

SECTION I. Statutory Provisions.

Section 16 of the Federal Reserve Act authorizes the Federal Reserve Board to require each Federal re-

serve bank to exercise the function of a clearing house for its member banks, and section 13 of the Federal Reserve Act, as amended by the act approved June 21, 1927, authorizes each Federal reserve bank to receive from any nonmember bank or trust company, solely for the purpose of exchange or of collection, deposits of current funds in lawful money, national bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills, provided such nonmember bank or trust company maintains with its Federal reserve bank a balance sufficient to offset the items in transit held for its account by the Federal reserve bank.

SECTION II. General Requirements.

In pursuance of the authority vested in it under these provisions of law, the Federal Reserve Board, desiring to afford both to the public and to the various banks of the country *a direct, expeditious, and economical system of check collection and settlement of balances,* has arranged to have each Federal reserve bank exercise the functions of a clearing house and collect checks for such of its member banks as desire to avail themselves of its privileges and for such nonmember State banks and trust companies as may maintain with the Federal reserve bank balances sufficient to qualify them under the provisions of section 13 to *send* items to Federal reserve banks for purposes of exchange or collection. Such nonmember State banks and trust companies will hereinafter be referred to as nonmember clearing banks.

Each Federal reserve bank shall exercise the functions of a clearing house and collect checks under the general terms and conditions hereinafter set forth.

SECTION III. Checks Received for Collection.

(1) Each Federal reserve bank will receive at par from its member banks and from nonmember clearing banks in its district, checks drawn on all member and nonmember clearing banks, and checks drawn on all other nonmember banks which are collectable at par in funds acceptable to the Federal reserve bank of the district in which such nonmember banks are located.

(2) Each Federal reserve bank will receive at par from other Federal reserve banks, and from all member and nonmember clearing banks in other Federal reserve districts which are authorized to route direct for the credit of their respective Federal reserve banks, checks drawn on all member and nonmember clearing banks of its district, and checks drawn on all other nonmember banks of its district which are collectible at par in funds acceptable to the collecting Federal reserve bank.

(3) No Federal reserve bank shall receive on deposit or for collection any check drawn on any nonmember bank which can not be collected at par in funds acceptable to the Federal reserve bank of the district in which such nonmember bank is located.

SECTION IV. Time Schedule and Availability of Credits.

(1) Each Federal reserve bank will publish a time schedule showing the time at which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank. For all checks received, the sending bank will be given immediate credit, or deferred credit, in accordance with such time schedule, and as provided below.

(2) For all such checks as are received for immediate credit in accordance with such time schedule, immediate credit, subject to final payment, will be given upon the books of the Federal reserve bank at full face value in the reserve account or clearing account upon day of receipt, and the proceeds will at once be counted as reserve and become available for withdrawal or other use by the sending bank.

(3) For all such checks as are received for deferred credit in accordance with such time schedule, *deferred credit, subject to final payment,* will be entered upon the books of the Federal reserve bank at full face value, but the proceeds will not be counted as reserve nor become available for withdrawal or other use by the sending bank *until such time as may be specified in such time schedule,* at which time credit will be transferred from the deferred account to the reserve account or clearing account subject to final payment and will then be counted as reserve and become available for withdrawal or other use by the sending bank.

SECTION V.—Terms of Collection.

The Federal Reserve Board hereby authorizes the Federal reserve banks to handle such checks subject to the following terms and conditions; and each member and nonmember clearing bank which *sends* checks to any Federal reserve bank for deposit or collection shall by such action be deemed (*a*) to authorize the Federal reserve banks to handle such checks subject to the following terms and conditions, (*b*) to warrant its own authority to give the Federal reserve banks such authority, and (*c*) to agree to indemnify any Federal reserve bank for any loss resulting from the failure of such sending bank to have such authority.

(1) A Federal reserve bank *will act only as agent* of the bank from which it receives such checks *and will assume no liability except for its own negligence* and its guaranty of prior indorsements.

(2) A Federal reserve bank may present such checks for payment or *send such checks for collection direct to the bank on which they are drawn* or at which they are payable, or in its discretion may forward them to another agent with authority to present them for payment or send them for collection direct to the bank on which they are drawn or at which they are payable.

(3) A Federal reserve bank may in its discretion and at its option, either directly or through an agent, *accept either cash or bank drafts in payment of or in remittance for such checks and shall not be held liable* for any loss resulting from the acceptance of bank drafts in lieu of cash, nor *for the failure of the drawee bank or any agent to remit for such checks,* nor for the nonpayment of any bank draft accepted in payment or as a remittance from the drawee bank or any agent.

(4) Checks received by a Federal reserve bank on its member or nonmember clearing banks will ordinarily be forwarded or presented direct to such banks, and such banks will be required *to remit or pay therefor at par in cash or bank draft* acceptable to the collecting Federal reserve bank, *or* at the option of such Federal reserve bank *to authorize such Federal reserve bank to charge their reserve accounts or clearing accounts;* provided, however, that any Federal reserve bank may reserve the right in its check collection circular to charge such items to the reserve account or clearing account of any such bank at any time when in any particular case the Federal reserve bank deems it necessary to do so.

(5) Checks received by a Federal reserve bank payable in other districts will be forwarded for collection upon the terms and conditions herein provided to the Federal reserve bank of the district in which such checks are payable.

(6) The amount of any check for which payment in actually and finally collected funds is not received *shall be charged back to the forwarding bank,* regardless of whether or not the check itself can be returned.

SECTION VI.—Other Rules and Regulations.

Each Federal reserve bank shall also promulgate rules and regulations not inconsistent with the terms of the law or of this regulation, governing the details of its check clearing and collection operations. Such rules and regulations shall be set forth by the Federal reserve banks in their letters of instruction to their member or nonmember clearing banks and shall be binding upon any member or nonmember clearing bank which *sends* any check to such Federal reserve bank for collection or to any other Federal reserve bank for the account of such Federal reserve bank for collection.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

The Opinions of the Courts Below.

The order of judgment made by the District Judge (R. 11) is not officially reported.

The opinion in the Circuit Court of Appeals, 4th Circuit (R. 68), is officially reported in 30 Fed. (2d) 198.

A petition for rehearing was filed and this was refused by formal order filed of date April 9th, 1929 (R. 94).

II.

Jurisdiction.

1. The statutory provision believed to sustain the jurisdiction is Judicial Code 240, as amended by the Act of February 13th, 1925 (12 U. S. C. A., 347 (*a*)), as follows:

> "In any case, civil or criminal, in a Circuit Court of Appeals, or in the Court of Appeals of the District of Columbia, it shall be competent for the Supreme Court of the United States, upon the petition of any party thereto, whether Government or other litigant, to require by certiorari, either before or after a judgment or decree by such lower court, that the cause be certified to the Supreme Court for determination by

it with the same power and authority, and with like effect, as if the cause had been brought there by unrestricted writ of error or appeal."

2. The decision sought to be reviewed was first filed on January 14th, 1929. A petition for rehearing being, however, presented to the Circuit Court, the order denying the petition was filed of date April 9th, 1929 (R. 94).

3. The decision of the Circuit Court of Appeals is in effect a final judgment in the cause. The case was tried on a stipulation of facts and the record on the second trial will of necessity be exactly the same as it was on the first trial. Therefore, while the decision of the Circuit Court is not final in form, it is unquestionably final in character, as it conclusively determines the judgment to be entered up in the court below. Especially in view of the public interests involved,—with the great volume of check collections throughout the entire country now being handled through the Federal Reserve System under the provisions of the Federal Reserve Act and the regulations issued pursuant thereto by the Federal Reserve Board,—a prompt decision by this court is, we respectfully submit, of such importance that a writ of certiorari ought to be allowed at this stage of the proceedings without further protracting the litigation to the extent that it would be necessary in order to reach final judgment.

4. The following cases are believed to sustain the jurisdiction and to justify the application for cer-

tiorari, notwithstanding the Circuit Court of Appeals remanded the case for a new trial:

United States *v.* Gulf Refining Co., 268 U. S. 542.
Spiller *v.* Railroad, 253 U. S. 117.
Forsyth *v.* Hammond, 166 U. S. 506.
American Const. Co. *v.* Railroad, 148 U. S. 372.

In the Gulf Refining Co. case it was said:

> "And the petition may be granted, notwithstanding the Circuit Court of Appeals remanded the case for a new trial and did not render a final judgment therein."

In the Spiller case it was said:

> "* * * upon the consideration of the particular circumstances of the case, we have concluded that a writ of certiorari ought to be allowed, without further protracting the litigation to the extent that it would be necessary in order to reach final judgment."

III.

Statement of the Case.

The summary statement of the matter involved, as made in the petition, covers the main material facts. A brief analysis of the Federal Reserve System of check clearing and collection may perhaps aid understanding of the situation of the parties and bring out more clearly the nature of the obligation assumed by the Lake City bank in respect to the checks forwarded for collection.

In rewriting Regulation J, following the decision in Federal Reserve Bank *v.* Malloy, 264 U. S. 160, the apparent object was to give the Federal reserve banks a greater latitude of discretion, with more complete protection against liability in carrying out the expressed policy of "a direct, expeditious and economical system of check collection." The clearing-house facilities of the Federal reserve bank were made available—(1) to all member banks desiring to avail themselves of such privileges, and (2) to nonmember banks and trust companies, subject, however, to the requirement that any such nonmember bank or trust company should maintain with its Federal reserve banks "a balance sufficient to offset the items in transit held for its account by the Federal reserve bank" (Appendix B).

Each reserve bank was required to publish a time schedule showing the time at which any item sent by it would be counted as reserve and become available for withdrawal or other use by the sending bank. Section IV (1). For checks drawn on South Carolina banks, this was three days (R. 57). Deferred credit was given to the sending bank in accordance with the time schedule, subject to final payment, but the proceeds not to be counted as reserve nor to become available for withdrawal or other use by the sending bank until the time specified in the time schedule, Section IV (3).

The terms of collection, specified at length in section V, required the forwarding banks to take every risk of the clearance. The provisions contained—(*a*) express notice that the reserve bank "*will act only as agent,*" and "*will assume no liability except for its*

own negligence;" (*b*) advice to the forwarding banks that the reserve bank will, in its discretion, send checks *direct* to the banks on which they are drawn,—regardless of whether the drawee banks are member banks or nonmember clearing banks; (*c*) advice to both the forwarding and remitting banks outlining acceptable methods of payment or remittance for the collection items; (*d*) advice to the remitting banks of the alternative method of remitting for the collection, optional to the reserve bank, "to *authorize* such Federal reserve bank to charge their reserve or clearing accounts"; (*e*) advice to the forwarding banks that unless payment is received "in actually and finally collected funds," the amount of *the uncollected check will be charged back,* "regardless of whether or not the check itself can be returned" (R. 45-46).

The "cash letter" method of handling the collection items is not dependent upon the state of the reserve or clearing accounts of the banks on which the checks are drawn. So far as any requirement or assurance of the check collection regulations is concerned, checks may also be sent direct to banks that have no reserve or clearing accounts and that are not even affiliated with the clearing system. See American Bank & Trust Co. *v.* Federal Reserve Bank, 262 U. S. 643. Even as to the banks having reserve or clearing balances against which the checks are declared to be chargeable, the particulars of the balances could not be known to the owners of the checks.

The lack of reliance to be placed on the reserve balances as a special fund or security for the collection

items in transit is obvious in the present case on examination of the ledger entries (R. 64-65). The reserve balance on the morning of October 8th was $32,196.00; charges against the deposit account of the 8th, $33,565.00; with $28,150.00 as credits. The balance on the 9th was $26,781.00; charges, $21,848.00; credits, $17,153.00. On the 11th, after the bank had closed, the balance (corrected) was $22,088.00, or lacking $12,982.85 of being enough to meet the cash letters outstanding (R. 32-33). The entries between the dates of September 23rd and September 27th are even more illustrative of the uncertainties of the reserve balance. On September 24th over $40,000.00 in collection items were apparently outstanding against the Lake City Bank, with the reserve balance then depleted to $2,880.00. Following withdrawals of over $60,000.00 on the 23rd, substantial deposits were made within the next few days and the cash letters, which on the 24th had practically no protection so far as the reserve deposit was concerned, were regularly met when they became chargeable.

Substantial balances may exist today; are gone tomorrow; are restored; the cash letters are paid; and the bank carries on. Or, on the other hand, the substantial balance which exists when the checks are dispatched for collection, and even when the checks are accepted, may be drawn out in a day's business; and, from the standpoint of security to the owner of the collection items, the intangible substance of the evanescent balance has faded into nothingness when the bank fails.

IV.

Specification of Errors.

1. The Circuit Court erred in the underlying premise upon which the opinion rests in holding that:

> "The checks were sent to the drawee (the Lake City Bank) upon the distinct and definite agreement that they were to be paid out of the funds of the reserve account of the drawee by charging them to that account."

2. The Circuit Court erred in the conclusion stated in the opinion that:

> "Although in this case the transit period had not ended at the time of the closing of the drawee bank, the rights of the owners of the checks to have them charged against the reserve balance of the drawee had become fixed and irrevocable."

The opinion states the material question in issue:

> "Whether the deposit balance in favor of the insolvent bank should be applied on the checks in question, as contended by the Reserve Bank?"

At the outset of its discussion of this question, the court assumed the conclusion, in substance, as follows:

> The right of the owners of the checks to demand that they be charged against the drawee's account and that the balance of that account be applied by the Reserve Bank to their payment, became fixed, so as to constitute it a charge upon the reserve balance, when the checks were

accepted by the drawee, and charged to the account of the various drawers.

The reason for assuming the foregoing conclusion does not, however, appear until almost at the end of the opinion, the following the holding that the case of Equitable Trust Co. *v.* First National Bank of Trinidad, 275 U. S. 359, is not authority against the position of the Reserve Bank (R. 75). In making that declaration and for the purpose of distinguishing the facts of the present case from the Bank of Trinidad case, the court stated the premise which, as above pointed out, we believe to be erroneous and unfounded and which, from the error therein, has naturally resulted in an erroneous decision.

V.

ARGUMENT.

Summary of Argument.

The petitioner contends:

A.

That there was neither agreement of the parties nor understanding implied from the terms of collection equitably to assign any part of the reserve balance or to treat such balance as a specified fund pledged as security to the payment of the accepted checks.

B.

That the exercise of the clearing-house functions of the Reserve Bank was not based upon the faith of the

reserve balances and the authority of the Reserve Bank to make charges against the reserve account of the drawee bank was revoked by the insolvency of such bank.

C.

That the principles declared by this court in Equitable Trust Co. *v.* First National Bank of Trinidad, 257 U. S. 359, should have been held by the Circuit Court to be controlling against the position of the Reserve Bank.

POINT A.

There was neither agreement of the parties nor understanding implied from the terms of collection to create an equitable lien or charge on the Reserve balance as security for the payment of the checks.

The assignment of the reserve balance, if it existed, has to be implied from the terms of collection under which the checks were handled. The acceptance of the checks by the drawee bank was not followed either by setting apart a specified sum to meet their payment or by express assignment of any part of the reserve balance. There were no unusual circumstances of the transaction. No assurance was given that the particular fund in the reserve account should be the source from which payment should be made. The cash letters under which the checks were forwarded contained

merely the notation that two business days later they would become *"chargeable against available balance in reserve account."* An assent to these terms carried with it neither tender of security nor any representation other than the understanding that the drawee bank would, at its convenience within the agreed transit time, provide funds to make the payment at the Reserve Bank.

It said, however, that the check collection circular, prescribing the terms of collection, establishes the right to make the charge as contended by the Reserve Bank. But this circular letter plainly states that the drawee bank has *"within the agreed transit time"* the right *"either* to remit * * * *or* to provide funds available to us (the Reserve Bank) to meet such cash letters." The provision then follows:

> *"Therefore, the amount of any cash letter to a member bank is chargeable against available funds in the reserve account of such member at the expiration of such transit time, which date will be shown on each cash letter."*

The case of Fourth Street Bank *v.* Yardley, 165 U. S. 634, is cited in the Circuit Court opinion as authority for its position, quoting in part as follows:

> "* * * yet the authorities establish that if in the transaction connected with the delivery of the check it was the understanding and agreement of the parties that an advance about to be made should be a charge on and be satisfied out of a specified fund, a court of equity will lend its aid to carry such agreement into effect * * *."

It will be noted, however, from the quotation that even the equitable relief afforded by a court of equity in the Yardley case was dependent upon the understanding and agreement of the parties that an advance about to be made *"should be a charge on and be satisfied out of a specified fund."* The error of the Circuit Court in assuming that the position taken by the Reserve Bank falls within the principle announced in the Yardley case clearly appears, we think, upon examination of the circumstances stated in the opinion as follows:

> "The transaction, therefore, was a proposition to borrow on the one hand, accompanied with the disclosure that security was necessary and tendering the security, and, on the other hand, an acceptance of such proposal and an advance made on the faith of it. * * *
>
> "It is impossible to infer otherwise that it was intended that the particular fund in the Tradesmen's Bank should be not only the source from which the payment of the check to be given should be made, but that the funds should be transferred and appropriated pro tanto for that purpose. * * *
>
> "As the Fourth Street Bank contracted and parted with its money on the faith of the representations of the Keystone Bank that there was to its credit, in the Tradesmen's Bank, a *specific sum,* and the fund which came into the hands of its voluntary assignee is this fund as to which the representations were made, the Keystone Bank and its assignee are in equity estopped from asserting, to the prejudice of the Fourth Street Bank, that the character and

condition of the fund was otherwise than it was represented to be" (165 U. S. 651-653).

The ordinary clearance transaction in the case at bar presents none of the elements appearing in the above stated facts, where there was (1) a proposition to borrow; (2) a disclosure that security was necessary; (3) tendering the security; (4) the acceptance of such proposal and an advance made on the faith of it; and, (5) the intention that the particular fund in the Tradesmen's Bank should be not only the source from which the payment of the check should be made, but that the funds should be transferred and appropriated pro tanto for that purpose.

In the case at bar we find the following salient features—(1) the recognized right of the drawee bank to use its reserve account for general purposes during the period between the acceptance of the collection items and the expiration of the transit time, which date was shown on each cash letter; and, (2) the right of the drawee bank *either* to remit, *or* to provide funds, at its own convenience, subject only to the simple unsecured agreement, *"to meet such cash letters within the agreed transit time to and from the member bank."*

THE PRINCIPLES GOVERNING EQUITABLE LIENS.

Any order, writing, or act which makes an appropriation of a fund amounts to an equitable assignment of the fund. Spain *v.* Brent, 1 Wall. 604.

An agreement to pay out of a particular fund, however clear its terms, is not an equitable assignment, if

the assignor retains any control over the fund. Christmas *v.* Gaines, 14 Wall. 69; Meyer *v.* Delaware R. Constr. Co., 100 U. S. 457.

An agreement to remit for collection items, even where the remittance is to be made by draft or a charge against a particular deposit account, does not constitute an assignment or create an equitable charge against the deposit. Christmas *v.* Gaines, 14 Wall. 69.

In the interborough Consolidated Corporation case, 288 Fed. 334, 32 A. L. R. 932, 947 (certiorari denied, 262 U. S. 752, 67 L. Ed. 1215), it is said:

> *"A particular fund is not 'charged' unless it is bound for the performance of an obligation imposed."*

The application of the same principle is found in Woodhouse *v.* Crandall, 197 Ill. 104, 58 L. R. A. 385, where it is said:

> "The banking firm assumed the position of a trustee and the money deposited constituted a trust fund *which the bank was bound to keep intact for the purpose of the trust."*

In Pomeroy's Equity Jurisprudence (4th ed.) section 1235, a statement of the conditions under which equitable liens or charges may be created is made as follows:

> "In order, however, that a lien may arise in pursuance of this doctrine, the agreement must deal with some particular property, either by identifying it, or by so describing it that it can be identified, *and must indicate with sufficient*

> *clearness and intent that the property so described, or rendered capable of identification, is to be held, given or transferred as security for the obligation."*

So, in the case of United States *v.* Butterworth-Judson Corp., 262 U. S. 387, an equitable charge was held to be established by the deposit of money "in *special* accounts in banks *separate* from its other funds," to be drawn upon only for specific purposes. The basis of decision is stated in the opinion of Mr. Justice Butler as follows:

> *"The agreement made the balances in the special accounts security* for the obligations of the contractor, and so created an equitable lien * * * The purpose and effect of the special accounts was * * * *to limit the use of the funds to the purposes specified,* and so to make it available as security."

POINT B.

The exercise of the clearing functions of the Reserve bank was not based on the faith of the Reserve balance of the member bank.

The Federal Reserve Act originated in the need of stabilizing financial conditions. The requirement of reserve balances was designed primarily to provide available funds for the Federal reserve banks to take care of the financial needs of their member banks; the existence of which depended on the resources available to them and on the protection afforded to their

depositors. To give this protection was the main—because the most vital—object of the banking provisions. Reserves were necessary to safe banking. Each member bank was required to contribute his proportionate part to the strength of the financial system.

Under the terms of the Federal Reserve Act the exercise of clearing house functions was permissive but not mandatory (12 U. S. C. A. 248 (*m*)). This was seemingly considered as a minor part of the reserve system activities. There is no indication from any of the provisions of the act that clearing house functions of the system were even remotely in mind so far as the statutory provision for reserve balances was concerned.

The use of the reserve balance in the clearing system facilitated the handling of the collection items, simplifying the method of clearing. The reserve account is not a special account. Subject to prescribed penalties the reserve balance may be checked against and may even be completely withdrawn (12 U. S. C. A. 464); and the amount of the available balance at the expiration of the transit period is necessarily dependent on the extent of withdrawals and deposit occurring after the acceptance of the checks.

No limitation is made to preclude other use of reserve balance. No deposit is made, nor funds set apart, to be kept separate from other funds for the purpose of providing security for the handling of the collection items. On the contrary, the reserve balance, not being made specifically applicable to clearing purposes, is not required to be sufficient to cover the

items in transit held against the account of the depositor. It can be drawn upon by the depositor to meet the payment of other obligations. It can be applied by the reserve bank to the payment of the indebtedness of the depositor to itself.

There is no requirement that balances be carried for the purpose of meeting demands in transit; and the duty as declared in the check collection circular to provide available funds in the reserve account is without security for its performance.

Neither the amount of balances usually carried nor the probable extent of withdrawals nor the particulars of the balance at any given time are known to the owners of items when they use the Federal reserve system for the purpose of collections.

Checks drawn on nonmember and non-affiliated banks which have neither reserve nor clearing accounts are received for collection by the reserve banks and may be sent direct to the drawee bank. Consent that the checks be surrendered and the drawers released is based on nothing more than the mere contractual duty to remit by cash or bank draft,—subject to the hazard of possible insolvency of the drawee bank before the remittance is completed by the final collection.

THE AUTHORITY OF THE RESERVE BANK TO WITHDRAW FUNDS FROM THE RESERVE ACCOUNT OF ITS MEMBER BANK WAS REVOKED BY THE INSOLVENCY OF THE MEMBER BANK.

Nothing had been done toward the exercise of the right to make the charge against the reserve balance until after notice had been received that the Lake City

Bank had closed its doors. The subsequent appropriation of the reserve balance of the insolvent bank must necessarily stand on exactly the same footing as if made by its own officers. The act of the Reserve Bank in charging the member bank's reserve balance, as authorized by the regulation, has the same significance, and is exactly the same in practical results, as the act of a member bank itself in giving an order to the reserve bank by a check drawn on its reserve account to transfer funds from the account to meet the payment. Either act can be done before the bank closes, but not afterwards.

The conditions existing at the moment of insolvency could not be changed or altered by subsequent acts,—either those done by officers of the insolvent bank or those done in its name by the reserve bank under its power of attorney. The rights of the depositors and general creditors of the drawee bank to a pro rata distribution in all of its unpledged assets had become fixed at the moment of insolvency, and the attempt subsequently to create a favored class of creditors was utterly null and void.

12 U. S. C. A. 91.

Scott *v.* Armstrong, 146 U. S. 499.

An interest in the property upon which the power is to operate, and not merely an interest in the exercise of the power is essential to make a power of attorney one coupled with an interest so as not to be subject to revocation.

Taylor *v.* Burns, 203 U. S. 120.

In Hunt *v.* Rousmanier's Admr's, 8 Wheat. 174, 205, Chief Justice Marshall said:

> *"The interest or title in the thing being vested in the person who gives the power, remains in him, unless it be conveyed with the power, and can pass out of him only by a regular act in his own name. The act of the substitute, therefore, which in such a case is the act of the principal, to be legally effectual, must be in his name—must be such an act as the principal himself would be capable of performing, and which would be valid if performed by him."*

The foregoing principles are given application in the Columbia Shoe Co. case, 289 Fed. 465 (C. C. A. 2d Circuit), where the court, holding that the agreement previously made had been revoked by insolvency, said:

> "The power of attorney of April 27th added nothing to title. If anything it denied title. It merely permitted Speigel to act as attorney in fact for Columbia Shoe Co., so as to enable Speigel to make collections and to deposit in the corporation's name and to draw drafts, etc. in its name. This power of attorney was not in any sense coupled with an interest. Such a power, of course, presupposes a legal interest in the *res* of which the power is to be executed.
> • • •
> *"When the petition was filed the property of the bankrupt was in custodia legis, and the power of attorney was revoked by operation of law.* Mueller *v.* Nugent, 184 U. S. 1, 46 L. ed. 405; Lazarus *v.* Prentice, 234 U. S. 263, 58 L. ed. 1035."

Point C.

The decision of this Court in Equitable Trust Co. v. First National Bank of Trinidad, 257 U. S. 359, is authority against the position of the Reserve bank.

The settlement for the collection of the checks handled through the Federal clearing house system was to be made through the Reserve Bank which thus became, in effect, the drawee bank for the purpose of clearing the remittances. The funds when placed in the hands of the Reserve Bank would become available to be drawn upon by the owner of the collection items. The agreement of member banks,—under the rules of the clearing system,—to remit for items upon themselves can be fairly stated by using the words of Mr. Justice Holmes from the Bank of Trinidad opinion: "They are to provide the drawee banks (the Federal reserve banks) with sufficient funds for the payment *by transfer of credit from our balance 'or otherwise'*; they are to provide, that is, as convenient to themselves, for payment to the drawee banks (the Federal reserve banks), *not to give them an earmarked corpus to be handed over.*" The agreement does not set apart the deposit belance of the member bank as security for payment of the collection items; nor does it promise the appropriation of a specified fund.

It therefore seems to us that we are well justified in believing that the bank of Trinidad decision has a direct and controlling application in respect to the case at bar. The sole question there at issue was

whether a *special* account had been established and the use of the funds irrevocably limited to the purposes specified. The Circuit Court of Appeals, Second Circuit, 13 Fed. (2d) 732, 735, held that the equitable charge had been created by the agreement and acts of the parties, saying:

> "It seems to us the agreement to transfer the credit, *followed by its actual transfer,* provided a fund which the drawee was obliged to devote to the payment of the draft; that is, that it created an equitable assignment or an irrevocable declaration of trust by the bankrupts."

A writ of certiorari was applied for and was granted by this Court. In many respects the points made by the petitioner on his application for writ of certiorari are very similar to those upon which the petitioner in the present case has based his application. Upon the hearing of the cause, the court divided. The majority opinion, written by Mr. Justice Holmes, stated the conclusion that the transaction did not constitute the appropriation of funds for a specific use and did not show an intent to establish—

> "an attenuated property right in an account to which no special funds were attached and the particulars of which neither the respondent nor the purchaser of the check could know."

The analysis of the case made by Mr. Justice Holmes shows a consideration of three salient factors leading to this conclusion as follows: (1) the ignorance of the whole affair on the part of the holder; (2)

the general understanding that the account was subject to the bankrupt's control; and (3) that—

> "the terms offered by the bankrupt to their correspondents seem to us to promise the appropriation of a specified fund to the draft as little as they promise to apply the money received by them to that end. They are to provide the drawee bank with sufficient funds for the payment of the drafts by transfer of credit from our balance 'or otherwise'. They are to provide, that is, as convenient to themselves, for payment by the drawee bank, *not to give them an earmarked corpus to be handed over.* * * *"

For the purpose of comparison with the facts entering into the present situation, the three contractual elements of the banking transaction above reviewed will be summarized: (1) the agreement of the insolvent bank to provide sufficient funds to meet payment of the items; (2) the authority, or power of attorney, to the bank in which the funds of the insolvent bank were held on general deposit to make an appropriation of such funds for the purpose of payment; and (3) the setting apart of funds,—under such authority or power of attorney and in accordance with the standing agreement between the insolvent bank and the bank in which the deposit account was carried,—to a special "Drafts Payable" account for the purpose of meeting the items in transit.

Here we find,—under the provisions of Regulation J and the check collection circular issued pursuant thereto,—only the agreement to provide funds, and

the authority, or power of attorney, to make an appropriation of such funds for the purpose of the payment. The sole requirement of the insolvent bank was to provide sufficient funds to meet the payment of the checks at a later specified date, by transfer of credit from available funds in the reserve account 'or otherwise'. It was to provide these funds *in such manner as might be convenient to itself* within the three day transit transit period,—not to furnish upon the acceptance of the check, either "an earmarked corpus to be handed over", or "an attenuated property right in an account to which no special funds were attached."

In the Bank of Trinidad case the money was directly deposited with the bankrupt upon the agreement that it should be paid over to the owner through the clearing bank by establishing a credit which would be subject to the drafts of the owners of the money. In the case at bar, the owners of checks drawn on the bankrupt deposited the checks with the clearing bank for collection upon the agreement that, on the collections being made, the credit thereby established at the clearing bank would be subject to the drafts of the owners of the money.

The theory of a distinction between the two cases, as held by the Circuit Court of Appeals, seems somewhat difficult to follow in considering the application of the principles involved in the Bank of Trinidad opinion.

The division of opinion in the Bank of Trinidad case arose because of circumstances which were believed in the minority opinion to show the complete

performance of the bankrupt's agreement to provide funds, by setting apart in a special "Drafts Payable" account enough of its credit with the clearing bank to meet the payment of the items in transit. This feature of the Bank of Trinidad case, which was the basis of decision in the Circuit Court and also the basis of the minority opinion in this Court, is altogether lacking in the case now presented; and the agreement to provide funds stands by itself, without anything having been done to carry the agreement into effect until after the act of insolvency had occurred.

Conclusion.

The insolvent bank had no part in the preparation of the check collection circular, and even if it was susceptible of the meaning for which the Reserve Bank, its application would be governed, and the rights of the parties determined, by the rule that *doubt must be resolved against the party whose language becomes necessary to construe.* Moulor *v.* Insurance Co., 111 U. S. 335, 28 L. ed. 447. Ambiguities in a contract which was drawn by the attorneys, officers or agents of one of the parties, should be resolved, if it can be done consistently with the objects for which the contract is made, in favor of the other party. American Surety Corp. *v.* Pauly, 170 U. S. 133, 42 L. ed. 977.

In view of the nature of the case and the public interests involved in the determination of the question, it is, therefore, respectfully submitted that this case is one calling for the exercise by this Court of its su-

pervisory powers, and that to such end a writ of certiorari should be granted and this Court should review the decision of the Circuit Court and finally reverse it.

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